COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation Regarding the Appropriateness of the Use of Risk-Management Techniques to Mitigate Natural Gas Price Volatility	D.T.E. 01-100

Comments of The Berkshire Gas Company

Introduction and Executive Summary

The Berkshire Gas Company ("Berkshire" or the "Company") is pleased to have the opportunity to provide comments in response to the Department's Order Opening a Notice of Inquiry issued in docket D.T.E. 01-100. Berkshire notes that it has been active and creative in managing its resource portfolio to ensure least cost gas and reliable service for its customers, especially since the final implementation of FERC Order 636 in November 1993. Berkshire has utilized a range of opportunities in its resource management including restructuring contracts to be both flexible in its pricing provisions as well as the amount of gas purchased or delivered and the length of the contracts. By developing an efficient but flexible portfolio, the Company can provide least cost gas and reliable service for its customers. The Company has also worked with third party providers (see below) to help the Company gain more value in its portfolio by releasing capacity or making off-system sales when not needed by the Company's customers. This has resulted in additional savings to customers.

Pursuant to Order 636, local distribution companies such as Berkshire were required to secure and manage their own gas supplies and supply assets. In response, Berkshire implemented several initiatives in order to manage its own gas supplies. Berkshire, along with six other New

England gas utilities, formed the Mansfield Consortium. This collaboration enabled these smaller companies to "pool" their resources in order to secure more favorably priced supply contracts. The Mansfield Consortium afforded Berkshire greater market power and enabled Berkshire to secure more favorable prices while maintaining security of supply, thus mitigating risk**.** Berkshire also retained Pendulum Gas Resources to market off-system sales and release excess capacity on the Company's behalf. This arrangement was in place from 1993 through 1999. Berkshire secured substantial margins for the benefit of customers through this relationship.

Berkshire's resource management activities continued to recognize new opportunities that resulted from changing market or regulatory conditions. For instance, the Company had experienced migration from sales to transportation service which gave the Company an opportunity to adjust its resource portfolio. First, the Company went through extensive negotiations with Tennessee Gas Pipeline in the renewal of its capacity contracts. The revised contracts resulted in significant savings to customers in demand charges as well as the flexibility to reduce the amount of the maximum daily upstream capacity if market or regulatory conditions changed. Second, Berkshire was able to terminate a storage contract that was no longer required due to the migration on the Company's system. This also resulted in significant savings to customers. Finally, the Company terminated a long-term gas supply contract that included demand charges and replaced it with a short-term gas supply contract with minimal demand charges. Again, these efforts reduced cost and addressed price risk.

In addition to the contract revisions, the Company considered other ways in which it might further optimize its resource portfolio. Shortly after the Department's Order in 98-32-B, which unbundled the gas market for all customers on a state level, the Company went through a robust, competitive solicitation for an asset manager. The Company's solicitation sought to address Department mandates, but also exploit newly available opportunities for the benefit of customers. After substantial review and negotiation, the Company executed a contract with Energy USA-TPC Corporation ("TPC") to manage its assets for the period November 1999 through October 2000. The agreement was reviewed and approved by the Department in Berkshire Gas Company, D.T.E. 99-81 (1999). During the term of the agreement, the Company's parent was acquired by the Energy East Corporation. Berkshire recognized that substantial new opportunities might be available for the benefit of customers as a result of the merger and considered opportunities to secure such customer benefits at the earliest date. Accordingly, Berkshire extended the TPC agreement through March 31, 2001 so that the Company could consider opportunities to combine its assets with other Energy East companies to gain more value for its customers.

In late 2000 and early 2001, Berkshire pursued an aggressive benchmarking effort to determine the opportunities that could be secured for customers through the combined efforts with other Energy East local distribution companies. Berkshire and these entities ultimately issued a request for proposals for a range of potential services, either on a combined or individual basis. As a result, the Company has been involved in an alliance arrangement with the other Energy East local distribution companies and BP Energy Company that was approved by the Department in Berkshire Gas Company, D.T.E. 01-41 (2001). This alliance established a cooperative initiative among BP Energy and the LDCs with the objective of lowering gas costs while maintaining reliability of service. It is important to note that 100% of the optimization savings have been returned to firm sales customers, absent any threshold savings generated pursuant to D.P.U. 93-141-A. Additionally, the agreement with BP Energy Company includes a requirement for BP to provide a portion of the Company's daily gas supply needs. This requirement includes flexible pricing terms including the ability to establish a trigger price for the cost of the gas supply rather than relying upon the first of the month price index. While the Company has not exercised the trigger price option, it is a benefit that may reduce risk and provide more price stability for customers.

Consistent with the Department's directives in D.T.E. 01-41, the Company is now pursuing other opportunities through competitive solicitations as the BP Energy agreement nears the end of its term. The Company will advise the Department as to the results of these efforts and may petition the Department for any necessary approvals. Also consistent with the Department's directives in D.T.E. 01-41, Berkshire will issue a request for proposal to negotiate gas supply purchase agreements with various suppliers in anticipation of Berkshire's need to seek replacement gas resources. The Company expects to request flexible pricing and term provisions in these agreements so that the Company can react quickly to changing market and regulatory conditions.

In addition to managing its upstream resources as described above, the Company has been successful in the management of its downstream resources. For instance, the Company's aggressive and creative efforts, including the use of load management and conservation resources, deferred substantially the need for the Company's state-of-the-art LNG facility and, thus, resulted in cost savings to customers. Further, the development of the LNG plant resulted in substantial cost savings over more traditional resource alternatives. Finally, the Company's relationship with a local cogeneration facility provides peaking resources to customers at no cost unless the resources are used.

This brief summary demonstrates the aggressive, creative and continuing efforts of the Company to optimize its resource portfolio. Berkshire has sought to secure benefits and reduce price risk through a variety of initiatives, both long- and short-term. Berkshire believes that these efforts have helped the Company to address both price and volatility risk for the benefit of customers and led to several general conclusions. First, customer price and volatility benefits are secured best when the Company is flexible and responsive to changing conditions and new opportunities. Second, Berkshire expects that each local distribution company will have different opportunities to secure price and volatility benefits. The regulatory process should facilitate flexible, responsive and company-specific activities. Berkshire is concerned that extensive regulatory requirements or rules will lag behind market opportunities. Third, any consideration of risk management strategies should be symmetrical in terms of risks and benefits. That is the benefits of savings and the added costs of risk management strategies should be treated comparably if implemented pursuant to an approved resource and rate plan. In addition, the regulatory process should provide reasonable assurances that local distribution companies may rely upon when pursuing cost or volatility reduction strategies. The merits of approved strategies should not be revisited. Further, consideration of risk management strategies is best done in the context of a broader review of planning and ratemaking. For example, a company's rates should reflect the degree of risk assumed in terms of gas procurement and such rates should facilitate the informed execution of appropriate strategies and transactions. Finally, Berkshire believes that competitive solicitations are the best means to evaluate market opportunities. However, the nature of any particular solicitation should reflect then current opportunities and conditions. Thus, at times, more focused or targeted solicitations may be appropriate or timely.

<u>Comments Relating to Risk Management</u>

1. Should Massachusetts gas utilities be allowed or required to implement a risk-management program to mitigate price volatility for gas customers?

As a practical matter, local distribution companies are already under a mandate to secure a least cost gas portfolio. Most companies have implemented a variety of strategies in compliance with this mandate that also address price volatility. For example, the use of storage and peaking resources has the effect of securing cost and volatility benefits. Further, in the Department's Order in 98-32-B which unbundled the natural gas market on the state level, the Department accepted the concept of a "Portfolio Auction" so that all Massachusetts gas customers would have the ability to receive reliable, safe and least-cost service even if they were not able to purchase their gas from a third party marketer. Thus, it is the Company's position that Massachusetts gas utilities are already allowed to implement a risk-management program. However, the Department also stated in the Order that "the Department is not convinced that the auction will provide equal benefits for each and every LDC. Because we remain unconvinced of its universal applicability, we do not mandate the Portfolio Auction." Berkshire concurs that no single price or volatility strategy will be likely to work effectively for all companies. Accordingly, Berkshire submits that any change to the Department's regulatory mandate, if necessary at all, should be mindful of the need for flexible, responsive and company-specific strategies.

2. How will risk-management by LDCs affect gas unbundling and customer choice in Massachusetts?

As stated in the Company's comments previously, Berkshire has had much experience in managing its portfolio to provide least cost, reliable service to its customers. At the same time, Berkshire has endorsed and actively supported the transition to a more competitive gas market. Berkshire has worked actively with customers, marketers and other stakeholders to promote greater competition in its service area. The Company has seen significant migration of customers from sales to transportation on its system. As of December 31, 2001, 716 customers and over 38% of the Company's total volumes were for distribution service only. Further, residential as well as commercial and industrial customers are participating in the unbundled market. For these reasons, the Company does not believe that risk-management strategies aimed to reduce the overall cost of supply should affect gas unbundling and customer choice in Massachusetts.

3. Should gas utilities be limited to specific types of risk-management instruments? If so, what types?

Berkshire believes that LDC's should have clear direction as to the nature of permissible risk-management transactions. Berkshire has been able to rely upon the clear directives of the Department in this regard. See, D.T.E. 01-41. Berkshire believes that the Department should continue to allow the LDCs to choose whatever risk-management instruments will result in least cost, reliable service for its customers, as long as the LDC does not engage in any speculative financial arrangements. Alternatively, if an LDC wishes to pursue more speculative strategies, the LDC should be able to secure relevant regulatory approvals and, in turn, be able to rely upon the terms and conditions of such approvals.

4. Should there be a percentage volume of gas that LDCs would be allowed to hedge?

First, it is important to define what is meant by the term "hedge." Hedging could refer to a transaction where a company could receive a financial gain or loss depending on the circumstances of the arrangement. It could also refer to the ability to lock-in the price of gas at a predetermined price. For Berkshire's purpose, hedging refers to the latter.

In order to maintain diversity and flexibility in the LDCs portfolio, there should be a limit on the percentage volume of gas that an LDC would be allowed to hedge. For example, in the Company's gas purchase agreement with BP Energy Company discussed above, it was stated that the Company could establish a trigger price for the gas supply. Berkshire would not suggest establishing a trigger price for its entire gas supply portfolio. Rather, it would suggest anywhere from 10% - 30% would be reasonable. This insures if prices are reduced from the trigger price, the Company could capture some benefit for its customers. Alternatively, if prices increase, customers would have the benefit that a portion of their gas supply is below the market price.

5. What should the core objectives of a hedging program be (e.g., least cost, price stability)?

The core objective of a hedging program should be least cost, reliable service. While there may be periods where prices are unstable, over the long-term a properly implemented hedging program should result in stable prices as well. Berkshire believes that an overall least cost strategy (including the application of a variety of supply and demand-side resources and the application of multiple suppliers) has and will provide greater price stability.

6. How will the Department assess risk-management programs? What benchmarks should be used to measure a risk-management program's performance?

The Department should be flexible in reviewing any additional resource management strategy aimed at reducing risk. Any after the fact review should focus upon whether the resource strategies pursued were consistent with any approved plans or contractual arrangements and not the specific results of particular tactics.

7. What standard of review should the Department apply to the utilities' initial risk-management program?

The Department should apply a similar standard as applied in the review of incremental resources or the review of the forecast and supply plan, if any further risk-management program is deemed necessary. Again, LDC's should be able to rely upon any review and not be subject to hindsight review.

8. What types of costs are associated with risk-management? Should LDCs be allowed to recover these costs? If so, please explain how.

Initially, the Company would expect to incur transitional or administrative costs as it considers and presents alternatives to traditional portfolio management. If the costs are incurred in order to secure savings for customers, the LDC should be allowed to recover those costs. Again, if the LDC could not secure the savings for customers absent those costs, then the costs should be recoverable and included in the cost of gas adjustment factor.

9. Should an incentive mechanism be used in conjunction with a risk-management program? If so, please explain how this mechanism should be structured.

The Company believes an incentive mechanism already exists in the context of D.P.U. 93-141-A, at least for some risk management opportunities. More extensive risk management plans should be implemented in the context of a comprehensive planning evaluation and rate plan so that risk and reward are treated symmetrically and to ensure the implementation of an appropriate incentive structure. If more traditional risk management measures are implemented, adjustments to the parameters of D.P.U. 93-141-A should be considered. Essentially, D.P.U. 93-141-A allows a utility to retain 25% of the margins earned on capacity release, off-system sales, interruptible sales, or interruptible transportation transactions as long as the utility exceeds the earnings from the year before (for the period May 1 through April 30). In some cases, circumstances beyond a utility's control will affect margins in a particular year. For instance, if it is an extremely warm year, more interruptible transactions may occur. Further, if oil prices are high and gas prices are low, again more interruptible transactions may occur. If the alternative scenario occurred in the following year, margins would be reduced despite the fact that the Company's level of effort may be exactly the same. For these reasons, the Company would suggest that rather than exceeding a threshold each year, retaining a fixed percentage of all transactions on an annual basis gives the Company an appropriate incentive to continue managing its risk while sharing the rewards between customers and shareholders.